

Message Text

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ACTION SS-14

INFO OCT-01 ISO-00 EUR-08 EB-03 SP-02 TRSE-00 NSC-05

NSCE-00 SSO-00 FRB-01 CIAE-00 ONY-00 /034 W

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 7953

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SUBJECT: SITUATION REPORT, NOVEMBER 22

REF: (A) STATE 267168; (B) LONDON 18651

1. BOTH SUNDAY TIMES AND OBSERVER HAD FRONT PAGE ARTICLES HEADLINED "CABINET IN TOUGH TALKS WITH IMF" (TIMES) AND "TOUGH FIGHT OVER IMF DEMANDS" (OBSERVER). SOME MINISTERS (E.G. HAROLD LEVER, SHIRLEY WILLIAMS, AND ANTHONY CROSLAND) ARE REPORTED AS ALARMED AT PROSPECT OF IMF'S "POLITICAL CHIEFS" SUPPORTING "TOUGH OPTIONS" APPARENTLY INVOLVING "HEAVY DEFLATION AND A MAJOR REDUCTION IN PUBLIC SECTOR BORROWING NEXT YEAR." SUNDAY TIMES EDITORIAL SAYS IF IMF TEAM "IS TRYING TO IMPOSE FURTHER DEFLATION ON BRITISH ECONOMY," IT MISJUDGES BRITISH POLITICS AND ECONOMIC POSITION. "BRITAIN HAS HAD ENOUGH DEFLATION. THERE ARE NO RESOURCE ARGUMENTS FOR IT." EDITORIAL ARGUES STRONGLY AGAINST SURRENDERING TO MASOCHISTIC PSYCHOLOGY AND REGRESSIVE MEASURES. OBSERVER EDITORIAL SEES A NEED FOR RESISTING A PACKAGE WHICH IS GROSSLY DEFLATIONARY OVERALL, BUT SEES A REDUCTION IN THE PUBLIC SECTOR'S CLAIM ON RESOURCES AS THE KEY TO BETTER TRADE FIGURES.

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2. EXPENDITURE CUTS. THE SPILL OVER OF THE IMF TEAM'S VISIT INTO A THIRD WEEK IS ATTRIBUTED BY TODAY'S FINANCIAL TIMES TO THE NEED TO WORK OUT DETAILS OF A PACKAGE OF SPENDING CUTS AND TAX INCREASES OF 2 BILLION POUNDS OR MORE. THIS IS NEARLY A BILLION POUNDS MORE THAN THE PACKAGE WHICH FIGURED IN INITIAL PRESS REPORTS. THE FT REPORTS THAT THE INCREASE STEMS FROM THE EXAMINATION OF A LARGER CUT IN PUBLIC SPENDING. THE PACKAGE MAY COME IN TWO STAGES WITH SHORT-TERM FINANCIAL MEASURES (READ INDIRECT TAX INCREASES) BEING ANNOUNCED BY YEAR END WITH THE OTHER MEASURES (READ REDUCED PERSONAL INCOME TAXES AND FURTHER SPENDING CUTS) BEING HELD FOR THE APRIL BUDGET. THE TWO STAGE CONCEPT IS SAID TO HAVE ARISEN BECAUSE OF THE GREAT UNCERTAINTY IN CURRENT ECONOMIC FORECASTS, THE QUESTION MARKET REGARDING A FURTHER PERIOD OF WAGE RESTRAINTS, AND THE POSSIBLE DESIRE BY H.M. GOVERNMENT TO USE A SPRING PACKAGE WHICH INCLUDED PERSONAL INCOME TAX CUTS AS A BARGAINING COUNTER FOR WAGE RESTRAINT AS WAS DONE IN

3. ECONOMIC INDICATORS.

MONEY SUPPLY. THE BROADLY BASED MEASURE OF THE MONEY SUPPLY (M3) ROSE BY 1.2 PERCENT (0.538 BILLION POUNDS, S.A.) IN OCTOBER BRINGING THE TOTAL INCREASE OVER THE PAST 3 MONTHS TO 5.3 PERCENT. THIS IS ALMOST DOUBLE THE STATED TARGET (3 PERCENT PER QUARTER) FOR THE CURRENT FISCAL YEAR AND HELPS TO EXPLAIN LAST WEEK'S NEW RESTRICTIONS ON BANK LENDING. THE OCTOBER FIGURES BRINGS TOTAL M3 GROWTH FOR THE FIRST SEVEN MONTHS OF FY 76/77 TO 9.7 PERCENT, LEAVING A BARE 2.3 PERCENT INCREASE AVAILABLE FOR THE REMAINDER OF THE PERIOD. THE MORE NARROWLY DEFINED MONEY SUPPLY MEASURES (M1) FELL BY 1.8 PERCENT (333 MILLION POUNDS, S.A.) IN OCTOBER.

CONSUMER CONFIDENCE SAGS. THE DETERIORATING ECONOMIC SITUATION HAS LEFT ITS MARK ON BRITISH CONSUMERS. ACCORDING TO A MONTHLY FINANCIAL TIMES CONSUMER SURVEY, MORE PEOPLE FELT THAT THEIR SITUATION HAD WORSENED LIMITED OFFICIAL USE

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DURING THE CURRENT MONTH THAN IN ANY MONTH SINCE THE SURVEY BEGAN IN 1970.

4. FOREIGN EXCHANGE AND FINANCE. THE MINIMUM LENDING RATE (MLR) FELL TO 14-3/4 PERCENT AT FRIDAY'S TREASURY BILL AUCTION, AS WAS WIDELY ANTICIPATED IN FINANCIAL MARKETS. THE AVERAGE TREASURY BILL RATE, ON WHICH THE MLR IS CALCULATED, FELL 0.2516 PERCENT TO 14.0028 PER-

CENT. MONEY MARKETS ARE FEELING OPPOSING FORCES, AS
SHORT-TERM FIXED PERIOD INTEREST RATES CONTINUE TO DE-

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CLINE, WHILE DAY-TO-DAY CREDIT IS IN VERY SHORT SUPPLY.
IN THE INTERBANK MARKET, OVERNIGHT LOANS TOUCHED 17
PERCENT DURING FRIDAY, WHILE SIX MONTHS INTERBANK FUNDS,
WHICH BEGAN A SHARP RISE FROM NEAR 11 PERCENT ABOUT
SEPTEMBER 1, PEAKING AT NEAR 15 PERCENT ABOUT NOVEMBER
1, CLOSEAOXQY#ON FRIDAY.

THE POUND OPENED FRIDAY MORNING AT \$1.6960 ON THE
STRENGTH OF THE PREVIOUS DAY'S LATE TRADING IN NEW YORK
AND THE FAR EAST. THIS STRONG DEMAND FOR STERLING IS
THOUGHT TO HAVE REFLECTED APPROVAL OF THE MONETARY
CONTROL MEASURES ANNOUNCED LATE THURSDAY IN LONDON.
DURING THE DAY THE POUND EASED TO CLOSE AT \$1.6800,
WHICH REPRESENTED NEVERTHELESS A GAIN OF 2.05 CENTS ON
THE DAY. EARLY MONDAY TRADING SAW FURTHER EASING, AS
THE POUND STOOD JUST UNDER \$1.67 AT 10:30.

GILT PRICES CONTINUED TO INCREASE ON FRIDAY, WITH
MARKET DEMAND FOCUSED ON THE SHORT END OF THE MARKET.
THE NEW MONETARY CONTROL MEASURES, LOWER MLR, AND
STRENGTHENING STERLING ARE SAID TO HAVE REINFORCED THE

GROWING DEMAND. GAINS ON THE WEEK EXTENDED TO 1-3/4
POINTS. IN EARLY MONDAY TRADING GILT PRICES SHOWED
SMALL DECLINES OF 1/16 IN THE SHORTS TO 1/8 IN THE LONGS.

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THE GOVERNMENT ANNOUNCED LATE FRIDAY A NEW TAP
STOCK TO REPLACE THE 14 PERCENT 1982 WHICH THE WAVE OF
BUYING EXHAUSTED RECENTLY. THE NEW 800 MILLION POUND
TAP STOCK, THE "EXCHEQUER 13 PERCENT 1980", WILL BE
ISSUED AT 96-1/4, IMPLYING A YIELD OF 14.25 PERCENT.

CONTROL MEASURES, THE DECLINE IN THE MLR HAVING PERHAPS
BEEN DISCOUNTED. THE FINANCIAL TIMES INDEX OF 30
ORDINARY INDUSTRIALS CLOSED FRIDAY AT 307.2, DOWN 9.8
FROM THURSDAY'S CLOSE. EARLY MONDAY TRADING REVERSED
SOME OF FRIDAY'S LOSSES AS THE INDEX ROSE TO 311.5 BY
1030.

ARMSTRONG

NOTE BY OC/T: #AS RECEIVED.

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